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Economic Times

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Editor's Note

Our Colloquium steps out of the usual pattern this month, in that three of its four contributors are not members of the regular colloquium panel. We are grateful to them for tackling health-care costs, one of the most serious economic issues of our time. In the next issue of *Economic Times*, the same group will focus on the question of access to medical insurance.

In this month's issue we avail ourselves of the broad review of the global economic outlook by two veteran analysts from Bechtel. And we also get a brief look at a fascinating study made at Michigan's Institute for Social Research about how the people of different nations use their time.

Ed Fiedler

Maxim of the month:

A paranoid is a man who knows a little of what's going on.

William Burroughs

Miracle in Mexico?

A brief trip South of the Border recently provided an opportunity to catch up with the dramatic economic turnaround taking place in Mexico. After three highly satisfactory decades, the Mexican economy became a shambles in the 1980s. Starting in 1988, however, a remarkable recovery got underway. Economic growth has resumed. The inflation rate has been reduced from 159 percent in 1987 to about 17 percent this year. Real interest rates have come down sharply. Foreign investment is flowing into the country in large volume again. Most important, the Mexican people are beginning to regain faith in their economy and their government. Domestic investment is climbing smartly and the "flight capital" of the early 1980s is being brought home. Many analysts are calling it an economic miracle.

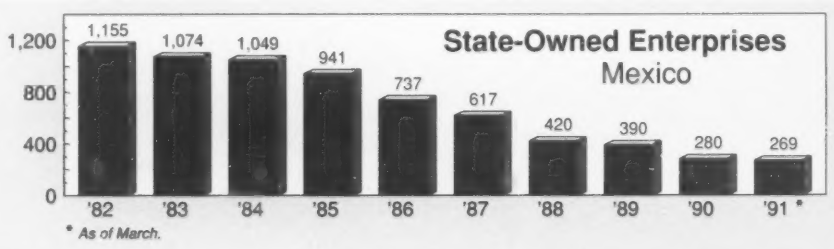
How did it all happen? It started with the indulgent and irresponsible government policies in the 1970s. The rise in oil prices, and much more, was squandered in wasteful government spending, subsidies, industry nationalizations and regulatory excesses. Mexico simply tried to live beyond its means.

The chickens came home to roost starting with the worldwide recession of the early 1980s. The difficulties were made to seem even worse by the unavoidably bitter medicine prescribed by President de la Madrid. Then in 1986 world oil prices collapsed. Both Madrid and his successor, President Salinas, however, persisted with highly disciplined economic policies: They have stripped away burdensome regulations, opened the economy internationally, reduced government spending sharply — from 45 percent to 30 percent of GDP — cut the federal deficit from 17 percent to 2 percent of GDP, and engineered a massive divestiture and liquidation of state-owned companies *(see chart)*. The payoff from these tough-minded policies appears promising.

How heavy were the costs? Draconian! Despite the recovery of 1988-91, the average manufacturing wage (adjusted for inflation) is still 2 percent below the level of a decade ago, and the minimum wage remains a shocking 52 percent lower. On average, the standard of living is still more than 10 percent below 1981.

The recovery is, therefore, far from complete, as is the reform of policy. Eleven percent of prices continue to be controlled by the government. Privatization still has a considerable way to go, including banking and steel. Inflation remains unacceptably high. But despite the reform that remains, the important story is how much has been achieved.

Is this a **miracle**? Probably not. Nevertheless, the turnaround of the Mexican economy is an extraordinary accomplishment, and we should tip our sombreros to Señors de la Madrid and Salinas. It's difficult to think of any other nation that has dealt as effectively with such a severe economic crisis. Latin America and Eastern Europe, take note!



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Colloquium: Health Care Costs

Background:

Health care now absorbs 12 percent of national income in the United States, a share already larger than most other nations, and rising relentlessly. Most of the increase represents rising costs per service rather than a larger quantity and quality of medical treatment. This seemingly inexorable trend frightens everyone who pays the bills, meaning almost everyone.

Question:

What are the most important changes that should be made to curb the rising cost of health care?

Henry J. Aaron
The Brookings Institution

Rising costs reflect the interaction between rapid scientific advance and a reimbursement system that is essentially open-ended because most patients are fully insured. No developed country exposes patients to significant financial costs. Controlling growth of health care outlays hinges on the creation of a budget constraint on hospitals. The solution is the imposition by a single payer of fixed budgets on hospitals and the denial of reimbursement for costly procedures outside the hospital setting.

Victor R. Fuchs
Stanford University

The U.S. should reduce the number of medical and surgical specialists, limit expansion of hospital facilities, and access more carefully the pace and character of technologic innovations. Additional savings should be sought in simplifying our system of finance and reimbursement and in the development and diffusion of cost-reducing technologies. Large buyers of medical care should use their bargaining power to eliminate any excess profits in the pricing policies of firms supplying the health care industry.

Walter J. McNerney
Northwestern University

Mild measures to curb costs haven't worked. We need tougher measures to: Change perverse incentives (e.g., limit tax deductions for employees and stop paying for units of care on a fee basis). Put limits on what we will pay up front (e.g., capitate managed care). Control the number and special distribution of physicians (with a need for more primary physicians). And exert tighter constraints over capital and technology. The health market is weak at best. It needs more potent buyer and regulatory inputs.

John T. Dunlop
Harvard University

To contain health care costs, which have been growing faster than the economy since the 1940s, the starting point is to promote fee-for-service medicine through organized medical groups. In addition we need research to define practice protocols and clinically effective care; federal pre-emption of state health insurance mandates; malpractice reform; standardized paperwork systems; education on the limits of medical intervention; and eventually a national forum to negotiate physician fee schedules and a hospital payment system.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Senior Fellow, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charls E. Walker, Chairman, Charls E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation. For this special topic (and next month's) we have added Henry Aaron, Director, Economic Studies Program, The Brookings Institution; Victor Fuchs, Henry J. Kaiser, Jr. Professor, Stanford University; and Walter J. McNerney, Professor of Health Policy, Northwestern University.

Around the World in Eighty Nanoseconds

by Denis M. Slavich and Michael B. Selvin

D.M. Slavich

M.B. Selvin

In 1872, Phileas Fogg and Passepartout astounded the world (of fiction) by circumnavigating the globe in eighty days. At present, by contrast, when a full-day of conversation can be burst in seconds between computers in different nations, and 747s routinely move hundreds of people and tons of goods between continents in hours, the world becomes a village and all markets become local markets.

Although the phenomenon of "instant communications" may be common knowledge, its impact on the world economy is still not appreciated. Ideas, even complex technical ideas, or wrong ideas for that matter, propagate the world at the speed of light. The clearest example is market forces, which by demonstrating economic success, are overwhelming centrally planned economies. With information readily available to everyone, it is difficult for politicians to maintain the status quo in any country, especially in countries that fall short in their standard of living or lack basic freedoms.

As a result, company planning can no longer focus merely on local economies and markets with impunity. Even if the company itself is not directly involved, its executives must understand the broad trends and longer term driving forces behind current international developments. Here are some of the key trends needed to understand the international economic outlook:

Continuing World Growth. For more than two decades, there has not been a year of negative growth for the world as a whole (first chart). Despite considerable volatility and great regional variations, the world economy shows a real growth trend of about 3 percent per year since World War II. Not surprisingly, the WEFA Group predicts 3 percent annual growth for the next five years.

Large Variance By Region. The outlook for any given region may be quite different and most importantly may be quite volatile. The WEFA forecasts shown indicate a return to a healthy growth in many regions. In particular, the developing countries and the Gulf states are expected to return to strong growth, while the centrally planned economies will continue to suffer slower growth as they make the difficult transition to a more market-oriented economy.

Sound Economic Policies. There is a growing realization of the critical importance of sound economic policies. When Taiwan and the Peoples' Republic of China split in 1949, they both had a per capita GNP of about $200. Since then, Taiwan's per capita GNP has increased to about 13 times the PRC's. Similar but less dramatic conclusions can be drawn from the two Koreas and the two Germanies (second chart). Open economies with free markets have demonstrated a capacity to speed development by stimulating changes in technology, which are incorporated rapidly into the economy.

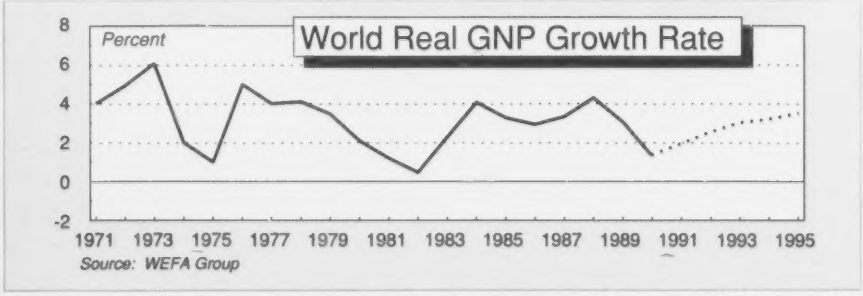
Growth Rates	*(percent per year)*		
	1970s	1980s	1990s
World	3.8	2.7	3.0
DevelopedCountries	3.2	2.8	2.8
DevelopingCountries	6.5	2.3	4.8
United States	2.7	3.0	2.1
EEC	3.1	2.2	2.9
Pacific Basin	8.1	6.5	6.9
Centrally Planned	3.9	2.9	1.4
Arabian Gulf	5.9	-0.2	4.2

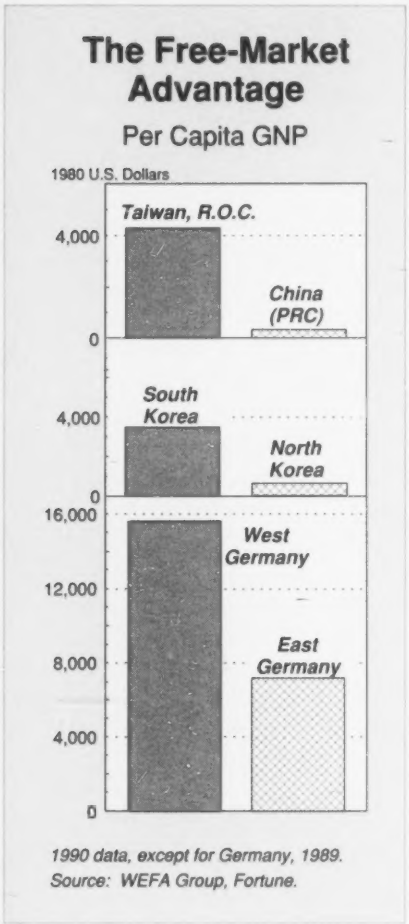
Source: WEFA Group

The Nobel prize-winning economist, Robert M. Solow, identified changes in technology as a key input to growth. But note that there is a critical feedback mechanism at work here. Free markets stimulate changes in technology, and these changes are incorporated far more rapidly into economies with free market policies. The most important contributor to economic growth, itself, grows better in private economies, reinforcing the entire growth process. Today, as a consequence, economies throughout the world are opening up: goods, services, and capital, and yes, technology, are flowing more freely.

In addition to more open economies, we are seeing greater international economic integration. The first step in this direction is well established — the development of true multinational companies — companies making decisions that transcend political boundaries. The next step is the free flow of capital between countries. This flow has been accelerating, which will lead to economic integration of regions such as the EEC and the North American trading group.

The third step, or trend, then, can be thought of as the triumph of economics over politics. This trend will not be





smooth however. Because the interests of politicians are generally directed at maintaining the status quo, politically motivated policies will retard or can temporarily stop the growth of market economies. When that happens, however, the costs will be high, and the people will not tolerate them for long.

Growing World Trade. World trade has demonstrated a strong secular growth trend. Although the growth of trade is highly volatile relative to GNP, it has been growing faster over the past twenty years than GNP, at a compound annual rate of over 4 percent (final chart). The U.S. experience underscores the importance of world trade. In contrast to a half-century ago, trade has become a critical element to our economy, but we do not have the power to dictate trade policies. As a result, trade has become a much more difficult political issue for the United States. In some of the European nations, trade makes up 50 percent of their GNP, and this is the direction we are headed.

Financial Flows. While most observers focus on trade, international financial flows are larger and growing more rapidly. World trade is about $4 trillion per year, or about $10-15 billion per day. By contrast, foreign exchange transactions account for $200 billion per day, or some 15-20 times annual trade volume.

The ultimate linkage among economies is foreign direct investment. Direct investment implies a true connection, based on the risks and rewards of investing in another country. Trade is indirect; investment is direct, participatory, and long-term. In the past few years, direct investment has grown faster than both trade and GNP, at an annual rate of almost 5 percent (final chart). As economic integration continues and barriers to the flow of international capital decline, this rate will increase, further integrating economies and hastening the transfer of technology.

The International Outlook

To summarize, the international outlook is positive. World GNP should grow in the 3 percent range over the next few years. Market forces will continue to enforce efficiency, even while they challenge political power and increase financial volatility.

In 1991 world growth will be positive but barely so. Approximately half the world (measured by GNP) is currently in recession, so this will be a difficult year.

The longer term is more interesting. Regional integration will continue strongly, with the EEC leading the way. The United States and Canada will continue as a trade block, with the participation of Mexico, and later others will join.

International trade will take on a greater importance to all countries, including the United States. The trend will entail globalization of manufacturing, that is, siting plants in optimum locations in relation to markets, suppliers, labor, raw materials, and government policies.

Software, communications, publishing, information, and other services are also being forced to compete on an increasingly international scale. The change in communications technology is doing to services what modern transportation technology did to trade in goods. Foreign direct investment will continue to outpace GNP and trade growth.

A country's growth prospects will depend upon how freely capital and technology flow into that country. Countries that are successful at attracting capital and technology should show growth well in excess of 3 percent. Countries that remain isolated will experience growth rates that are very low indeed.

Conclusion

When Phileas Fogg and Passepartout completed their journey, the world was suddenly a smaller place. Today, technology is accelerating the pace of change. The reward will be to those countries and companies that remain flexible and move fast, while at the same time provide for people and their needs. For even Mr. Fogg conceded he could have made the trip in 78 days by not crossing India.

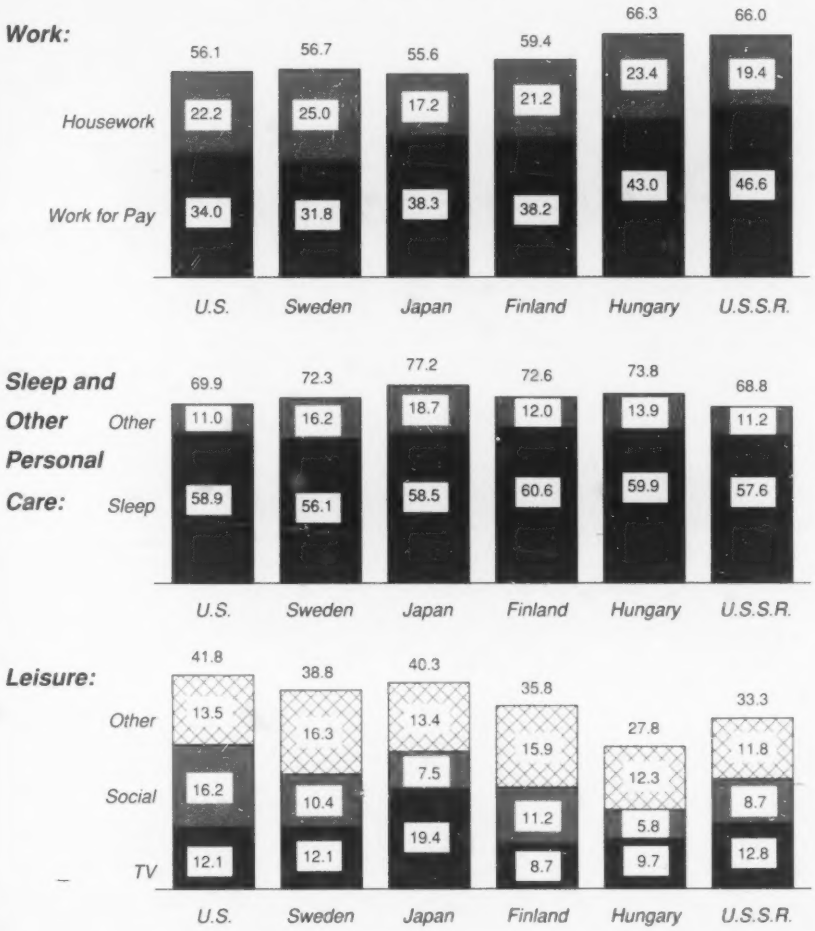
Messrs. Slavich and Selvin are with the Bechtel Group, Inc. This article is excerpted from Mr. Slavich's presentation to The Conference Board's Financial Outlook Conference, February 27-28, 1991.

How Do We Use Our Time?

by F.Thomas Juster and Frank P. Stafford

Work, Sleep and Leisure

(hours per week)



Time devoted to leisure tends to be greater, and time devoted to work shorter, in the high-income countries of the United States and Sweden than is true for Hungary and the U.S.S.R. This is consistent with the principle that over the longer term some of the gains in living standards are allocated to additional leisure, rather than to still higher consumption of goods and services.

In Sweden, the fewer hours spent working for pay, especially by men, and the greater number of hours spent doing housework, support the thesis that high marginal income tax rates in that country represent a deterrent to work for pay. The authors report that detailed data show Swedish men to be the clear leaders in home-improvement time, averaging over 4 hours per week in 1984. In contrast, men in the United States averaged 2.8 hours, and Japanese men less than one hour.

Sleeping time is, not surprisingly, very similar in all countries.

Watching television is much more prevalent in Japan than elsewhere, especially among women.

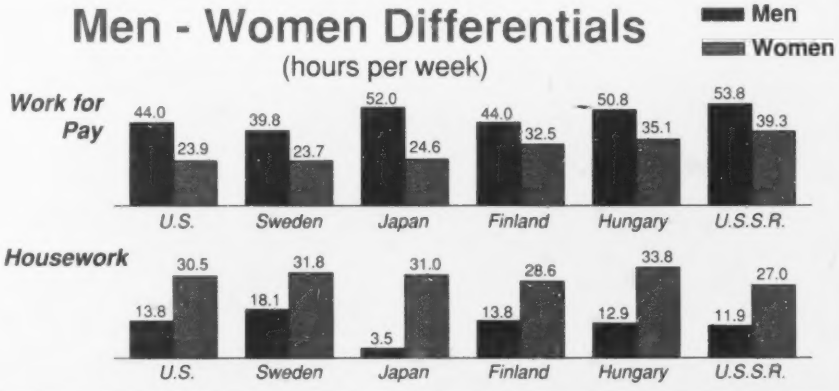
Time spent in social interaction is substantially higher in the United States than elsewhere, and is quite low in Hungary, Japan and the U.S.S.R.

Total work time (work for pay plus housework) tends to be longer for men than for women only in the higher income countries.

Housework by men (including routine chores, home projects and child care) is substantially longer than average in Sweden and strikingly low in Japan.

Men - Women Differentials

(hours per week)

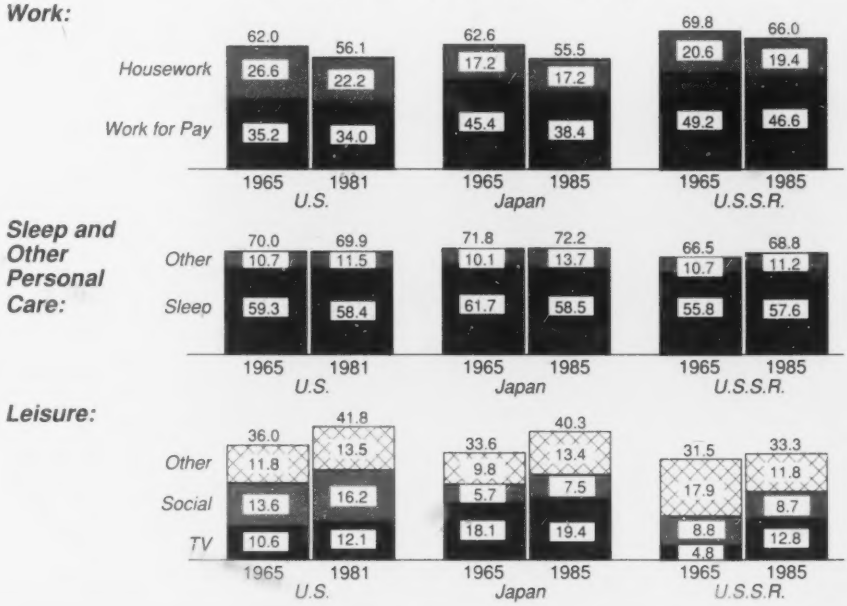


Time spent working, both for pay and in total, declined significantly in all three countries across the years.

Correspondingly, time spent in leisure pursuits increased. The dramatic increase in TV viewing in the U.S.S.R. (the City of Pskov) might have reflected (we can speculate) a wider availability of TV programming becoming available during the intervening years.

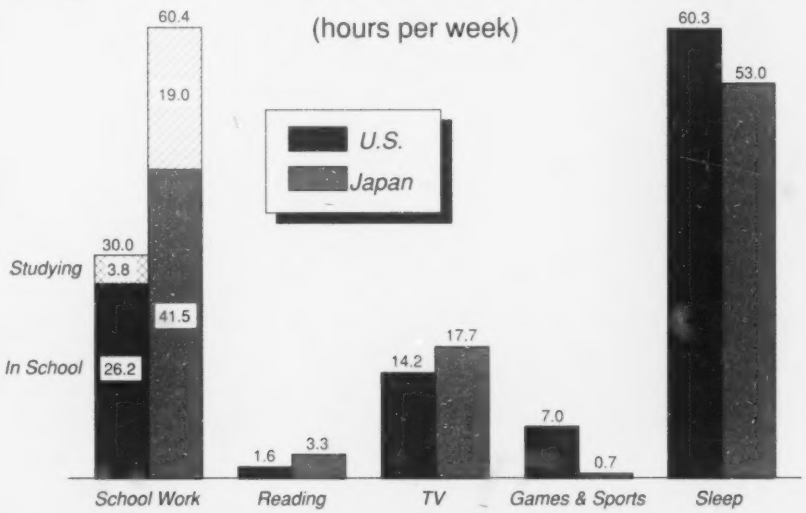
Changes in How We Use Our Time

1965-1980's (hours per week)



High School Students, U.S. & Japan

(hours per week)



The longer hours Japanese students spend on schoolwork compared to American children have been widely reported, but the extraordinary differences shown in this research — 50 percent more time in school and five times as many hours of homework — are startling indeed.

In view of the above, it is curious that Japanese high-schoolers also spend more time than their American counterparts reading and watching television.

American students devote more time to games and sports than the Japanese children do, and also spend more time sleeping. The authors also surmise that in addition the American youth spend more time "hanging around."

General Notes:

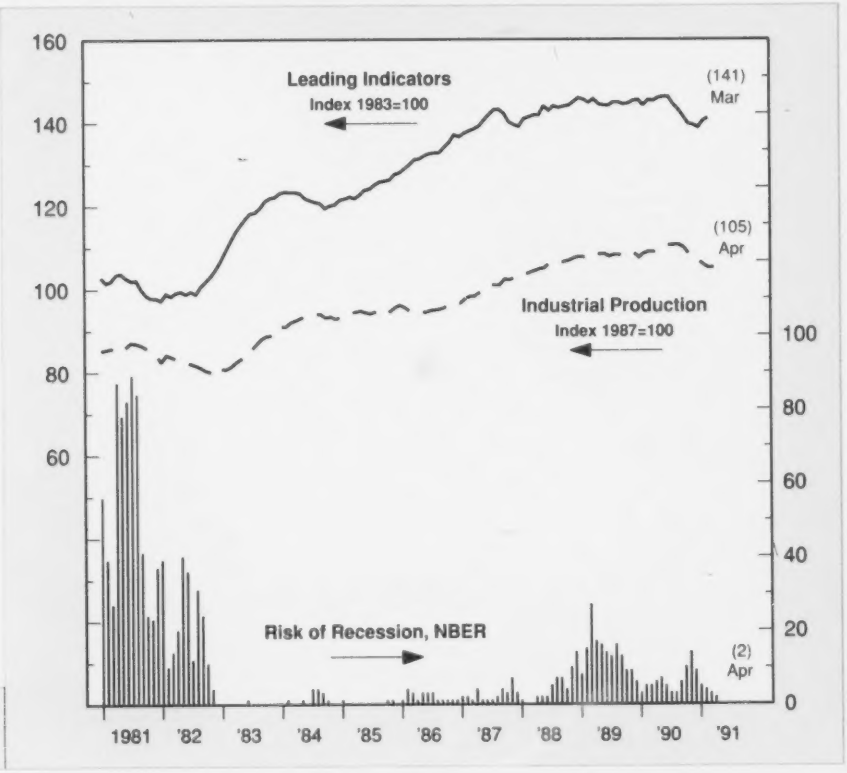
Excerpted from The Allocation of Time *by F. Thomas Juster and Frank P. Stafford, Institute for Social Research, The University of Michigan, forthcoming in the* Journal of Economic Literature, *June 1991. Data for the U.S.S.R. cover only the city of Pskov; all others are national data. Work for pay includes commuting time. "Social" represents time spent in social interaction, including visits to friends and neighbors, eating out, movies, and so forth. Hours reported in the first and third charts represent averages for adult men and women.*

Conference Board Stat File

Recovery Ahead, Slower than Normal but Better than Consensus

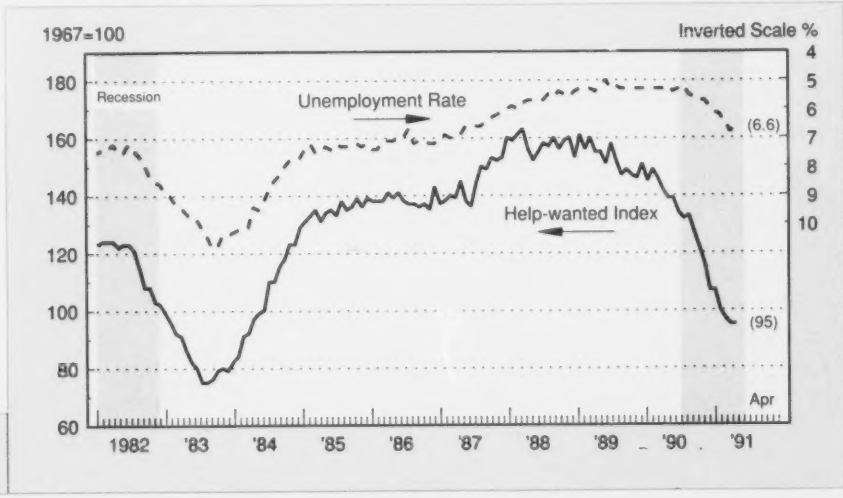
Whether the business-cycle recovery is just behind us (April/May) or just ahead (June/July) can't be determined now, but it's close enough to taste. That does not, of course, end all the bad news. When economists say the recession is over, it only means the economy has changed direction, not (as the public often interprets such a statement) that we economists think happy days are here again. The central issue is how vigorous will the recovery be? The consensus is, slower-than-normal. But that's what the consensus always calls for at this point. This time, however, there may be better reasons than usual for such a conclusion. (A greater-than-usual reluctance by the banks to extend credit, continued high real long-term interest rates, less-than-usual stimulus from the budget, and a general historical pattern that mild recessions beget mild recoveries.) I can agree with the forecast of a slow recovery but I'll put my nickel on a growth rate faster than the current consensus of 3-plus percent.

Early Warning Indicators



Cyclical recovery has started or is imminent.

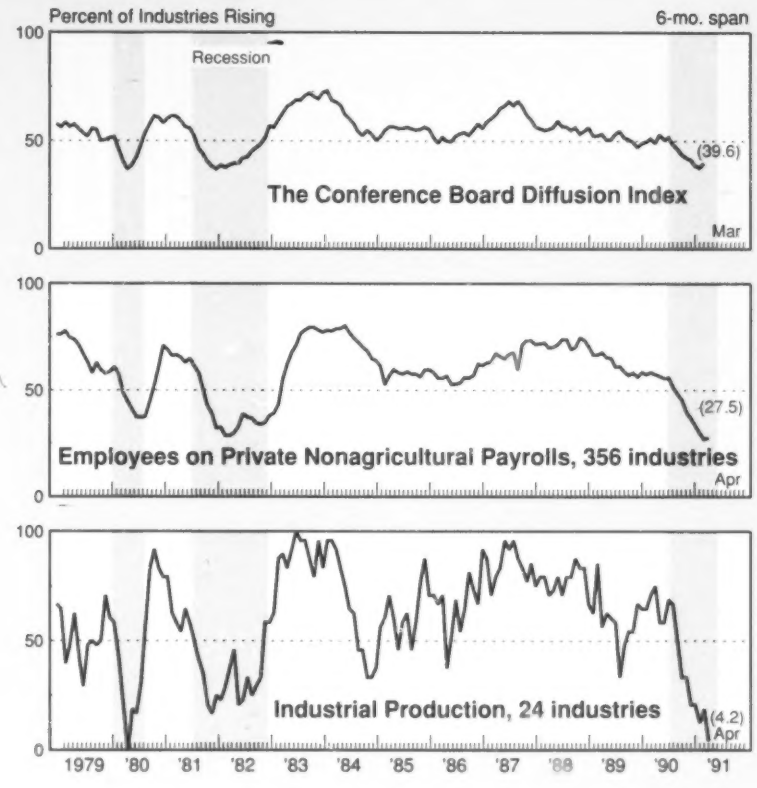
Help-wanted Advertising and Unemployment



Labor markets continue to be very weak.

Conference Board Stat File

Indexes of Economic Momentum



Confirmation of rebound not found here.

Inflation indicators look a bit better, but they still show no improvement over the earlier "base" rate.

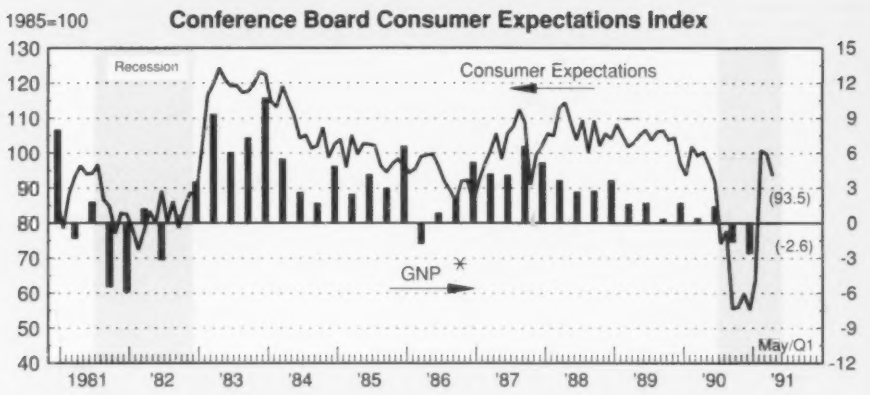
Inflation Fundamentals

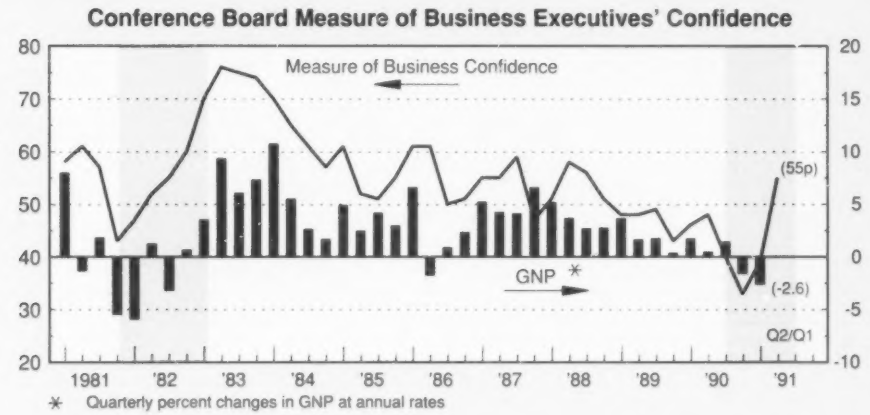
* Core Inflation = CPI excluding food at home and energy.

* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

Conference Board Stat File

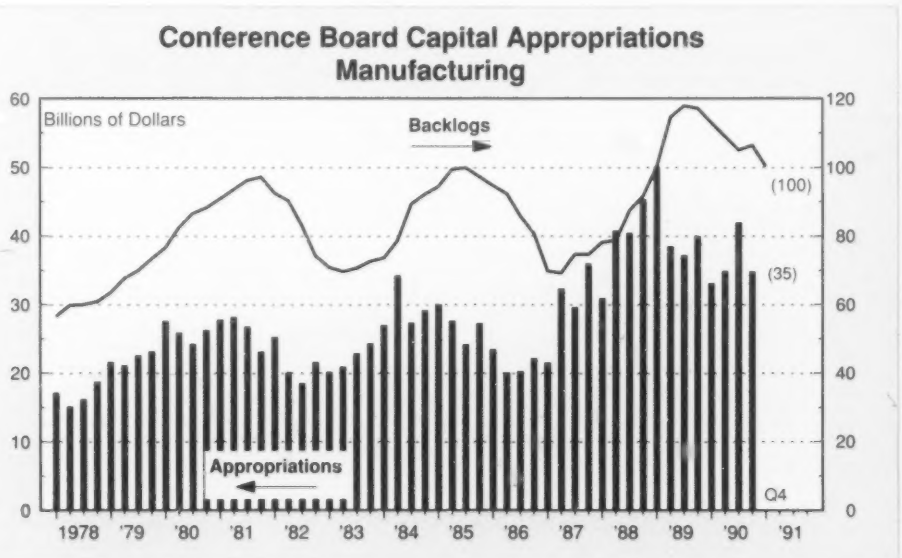
Confidence





Confidence measures consistent with at least a moderate recovery.

Investment Intentions



Appropriations holding up better than expected.

Inside the Crystal Ball

		UCLA	MERRILL L.	DU PONT	GEORGIA ST.	NORTHERN TRUST	CONF. BOARD	EATON	L.H. MEYER	DRI	WEFA	MICHIGAN – RSQE		
Date of Forecast		May	May	May	May	May	May	May	May	May	May	May		
Gross National Product		(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)												
		%	%	%	%	%	%	%	%	%	%	%		
Actual	1990 4Q	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	4Q 1990	Actual
	1991 1Q	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4	1Q 1991	
Forecast	2Q	-0.5	-0.4	-1.0	-0.3	0.8	2.4	1.7	-1.0	0.2	0.8	0.6	2Q	Forecast
	3Q	2.4	0.5	2.6	2.7	3.3	2.3	3.9	1.9	3.6	3.6	2.3	3Q	
	4Q	3.6	3.1	3.5	3.2	3.3	1.6	4.5	2.6	3.4	4.5	2.5	4Q	
	1992 1Q	4.1	3.0	3.1	2.8	3.1	2.4	4.2	4.0	3.7	5.0	2.6	1Q 1992	
	2Q	4.8	3.0	3.7	2.3	3.4	1.9	2.3	3.7	3.0	4.7	2.7	2Q	
	3Q	3.7	3.0	3.9	2.7	3.3	2.2	1.8	3.3	2.4	4.4	2.9	3Q	
	4Q	1.7	3.1	3.8	1.9	3.1	2.5	2.1	2.6	2.2	3.3	2.6	4Q	
	1993 1Q	1.9		3.7			2.4	4.1	3.0	2.3	3.1		1Q 1993	
	2Q	0.8		3.6			2.2	3.5	3.0	2.9	2.3		2Q	
Inflation (GNP Deflator)												(Percent change from same quarter one year earlier)		
Actual	1990 4Q	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	1990 4Q	Actual
Forecast	1991 4Q	3.6	4.3	4.1	4.0	4.4	4.4	3.0	4.0	3.5	3.1	3.8	1991 4Q	Forecast
	1992 4Q	2.8	3.7	3.6	3.9	4.0	4.7	2.6	2.8	3.2	3.1	3.4	1992 4Q	
30-Yr Treasury Bond Rate														
Actual	1990 4Q	8.6	8.6	8.6	8.6	8.6	8.6	8.6	8.6	8.6	8.6	8.6	4Q 1990	Acutal
	1991 1Q	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	1Q 1991	
Forecast	2Q	8.0	8.2	8.2	8.1	8.1	8.1	8.4	8.2	8.3	8.1	8.2	2Q	Forecast
	3Q	8.0	8.2	7.9	7.9	8.1	8.3	8.6	8.0	8.3	8.1	8.2	3Q	
	4Q	8.1	8.3	7.6	8.1	8.1	8.3	8.6	7.8	8.5	8.3	8.1	4Q	
	1992 1Q	7.9	8.3	7.7	8.2	8.2	8.6	8.5	7.7	8.8	8.4	8.0	1Q 1992	
	2Q	7.8	8.5	7.8	8.5	8.3	8.6	8.4	7.8	8.9	8.5	7.9	2Q	
	3Q	8.2	8.6	7.9	8.5	8.4	8.6	8.5	7.7	8.9	8.6	7.8	3Q	
	4Q	8.5	8.8	7.9	8.7	8.5	8.6	8.6	6.3	8.7	8.7	7.6	4Q	
	1993 1Q	8.7		8.0		8.6	9.1	8.7	6.2	8.7	8.8		1Q 1993	
	2Q	8.9		8.0			9.1	8.5	6.0	8.6	8.9		2Q	
Unemployment Rate													(Percent, quarterly)	
Actual	1990 1Q	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	1Q 1990	Actual
Forecast	1991 4Q	7.1	6.9	6.6	6.8	6.9	6.9	7.0	7.3	6.9	6.3	6.8	4Q 1991	Forecast
	1992 4Q	5.9	6.5	6.2	6.6	6.5	6.6	6.6	6.4	6.3	5.4	6.7	4Q 1992	
	1993 2Q	5.9		6.0			6.4	6.4	6.1	6.2	5.4		2Q 1993	

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